

Message Text

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FOLLOWING IS A REPEAT

QUOTE

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TO AMEMBASSY ADDIS ABABA

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E.O. 11652: N/A

TAGS: EINV, ET

SUBJECT: VALUATION OF EXPROPRIATED PROPERTY

REF: (A) ADDIS 6432; (B) ADDIS 6054; (C) ADDIS 5949;
(D) ADDIS 5895; (E) ADDIS A-43, DATED MARCH 5, 1975;
(F) ADDIS 2445; (G) ADDIS 2044

1. IN VIEW OF REPEATED APPROACHES TO EPMG BY EMBASSY
(REFS AND D-F) AND BY EEC COUNTRIES (REFS C AND G),
DEPARTMENT CONCURS WITH EMBASSY RECOMMENDATION PARA 3 REF
B THAT ADDITIONAL APPROACH CONCERNING USG POSITION ON

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DETAILS OF ASSET VALUATION NOT REQUIRED AT THIS TIME.
EMBASSY MAY NEVERTHELESS WISH TO DRAW FROM FOLLOWING
GENERAL COMMENTS IN FUTURE DISCUSSIONS WITH INVESTORS
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AND HOST GOVERNMENT OFFICIALS AS EPMG ELABORATES ITS

COMPENSATION POLICY.

2. IT IS THE LONGSTANDING POSITION OF THE USG THAT INTERNATIONAL LAW GENERALLY REQUIRES PAYMENT OF FAIR MARKET VALUE FOR EXPROPRIATED PROPERTY, CALCULATED AS IF THE EXPROPRIATORY ACT HAS NOT OCCURRED OR WERE NOT THREATENED. SINCE MARKET VALUE IS RARELY DIRECTLY ASCERTAINABLE, AND BECAUSE THERE USUALLY ARE NO RECENT SALES OF COMPARABLE PROPERTIES TO WHICH TO REFER, IT MUST GENERALLY BE APPROXIMATED BY OTHER METHODS OF VALUATION. THESE INCLUDE:

A. THE GOING-CONCERN APPROACH, WHICH ATTEMPTS TO MEASURE EARNING POWER (AND SO ENCOMPASSES ELEMENTS SUCH AS GOODWILL AND LOSS OF FUTURE PROFITS), AND IN OUR VIEW GENERALLY BEST APPROXIMATES THE MARKET VALUE OF THE INVESTMENT. IT INVOLVES AVERAGING PER-PERIOD EARNINGS OVER AN AGREED HISTORICAL PERIOD, AND THEN MULTIPLYING AVERAGE EARNINGS BY AN APPROPRIATE CAPITALIZATION RATE--A TASK REQUIRING CONSIDERABLE EXPERT JUDGMENT IN DETERMINING A MULTIPLIER ACCURATELY REPRESENTING A REASONABLE RATE OF RETURN FOR THE PARTICULAR INVESTMENT. THERE ARE CIRCUMSTANCES WHERE APPLICATION OF THIS METHOD IS IMPRACTICABLE, OR WHERE IT MIGHT OPERATE UNFAIRLY: FOR EXAMPLE, WHERE AN INVESTMENT HAS A LIMITED HISTORY OF OPERATING RESULTS, OR WHERE EXPROPRIATION OCCURS AFTER SIGNIFICANT COSTS ARE INCURRED BUT BEFORE A REVENUE-GENERATING STAGE IS REACHED. IT IS ALSO VULNERABLE TO HOST ACTIONS WHICH ADVERSELY AFFECT PROFITABILITY, SUCH AS INCREASED TAXES OR WITHDRAWALS OF PRIVILEGES. ALTHOUGH WE BELIEVE THAT SUCH ACTIONS TAKEN FOR THE PURPOSE OF INFLUENCING COMPENSATION SHOULD NOT PROPERLY BE ALLOWED TO DO SO, THE PURPOSIVE NEXUS BETWEEN ACTION AND EFFECT MAY BE DIFFICULT TO ESTABLISH.

B. THE REPLACEMENT COST OF THE FIRM'S ASSETS AT THE TIME OF EXPROPRIATION, A STANDARD WHICH MAY YIELD AN AMOUNT SUBSTANTIALLY HIGHER THAN BOOK VALUE, BUT WHICH IS NOT INTENDED TO REFLECT EARNING CAPACITY, LIMITED OFFICIAL USE

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IS OF LIMITED USE IN VALUING INTANGIBLES (SUCH AS GOODWILL), AND SO IS GENERALLY LESS ACCEPTABLE THAN THE GOING-CONCERN STANDARD.

C. BOOK VALUE, THE AMOUNT BY WHICH BOOK ASSETS (INCLUDING INTANGIBLES SUCH AS GOODWILL) EXCEED BOOK LIABILITIES. UNLIKE THE REPLACEMENT-COST APPROACH, ASSETS ARE VALUED AT ACQUISITION COST--A FIGURE

WHICH IN MANY CASES BEARS LITTLE RELATIONSHIP TO THEIR ACTUAL VALUE, PARTICULARLY IF THE INVESTOR EMPLOYS PERMISSIBLE METHODS OF ACCELERATED DEPRECIATION. WE BELIEVE THIS TO BE GENERALLY THE LEAST ACCEPTABLE METHOD OF VALUATION, AND ON AT LEAST ONE OCCASION HAVE INFORMED A HOST GOVERNMENT BY DIPLOMATIC NOTE THAT COMPENSATION BASED ON NET BOOK VALUE DID NOT MEET THE REQUIREMENTS OF INTERNATIONAL LAW.

3. AS INDICATED IN THE PRIOR PARAGRAPH, WE RECOGNIZE THAT NO SINGLE METHOD OF VALUATION IS VALID UNDER ALL CIRCUMSTANCES. INSTEAD, THE METHOD OR COMBINATION OF METHODS MOST LIKELY TO PROVIDE JUST COMPENSATION VARIES FROM CASE TO CASE, AND DEPENDS UPON ALL THE CIRCUMSTANCES OF THE PARTICULAR INVESTMENT. THE DETERMINATIONS OF WHICH METHODS TO EMPLOY, AND HOW TO APPLY THEM, POSE EXTREMELY COMPLEX AND SENSITIVE ISSUES, AND WE SUPPORT INDEPENDENT APPRAISAL AS A PROCEDURAL METHOD TO RESOLVE THEM. IT IS IMPORTANT, HOWEVER, THAT THE APPRAISER'S TERMS OF REFERENCE BE FORMULATED WITH A VIEW TOWARD PROVIDING FULL COMPENSATION IN THE PARTICULAR CASE.

4. IN PRACTICE, TERMS OF SETTLEMENTS TEND TO REFLECT RELATIVE BARGAINING STRENGTH BETWEEN THE PARTIES, AND BOOK VALUE IS OFTEN USED BY THEM AS A REFERENCE POINT IN NEGOTIATING MONETARY ASPECTS OF SETTLEMENTS. HOWEVER, RELATED NON-MONETARY ASPECTS--FOR EXAMPLE, ASSURED ACCESS TO SUPPLIES, PREFERENTIAL-PRICING ARRANGEMENTS, OR NEW CONTRACTS TO PROVIDE TECHNICAL OR MANAGEMENT SERVICES--ARE OFTEN SIGNIFICANT, AND ALTHOUGH DIFFICULT TO VALUE, MAY ALSO BE VIEWED AS ELEMENTS OF COMPENSATION LIMITED OFFICIAL USE

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IF INTENDED AS SUCH. WE SHOULD ENCOURAGE OUR INVESTORS TO MAKE CLEAR WHETHER, AND TO WHAT EXTENT, THE PARTIES CONSIDER SUCH CONTINUING RELATIONSHIPS TO BE PART OF THE SETTLEMENT PACKAGE. THIS ENHANCES OUR ABILITY TO DETERMINE WHETHER THE AGREED TERMS OF SETTLEMENT ARE BEING ADEQUATELY IMPLEMENTED, OR WHETHER THE INVESTOR'S RIGHT TO PURSUE JUST COMPENSATION (AND WITH IT OUR RESPONSIBILITY TO ACCORD HIM DIPLOMATIC PROTECTION AND, IF APPROPRIATE, TO ESPOUSE HIS CLAIM) REVIVES DUE TO DEFAULT BY THE HOST GOVERNMENT.

5. MOST INVESTMENT DISPUTES ARE RESOLVED WITHOUT ACTIVE USG INVOLVEMENT, AND WE RARELY OBJECT TO THE TERMS OF A SETTLEMENT ARRIVED AT WITHOUT COERCION OR FORMALLY TAKE

A POSITION ON THE ADEQUACY OF COMPENSATION. WE CAN, HOWEVER, PLAY AN IMPORTANT ROLE DURING NEGOTIATIONS BY MAKING OUR VIEW CONCERNING THE REQUIREMENTS OF INTERNATIONAL LAW KNOWN TO INVESTORS AND TO HOST COUNTRY OFFICIALS, AND TRYING TO ENCOURAGE A FAIR AND MUTUALLY-SATISFACTORY RESOLUTION OF OUTSTANDING ISSUES. WE ARE ALSO CONCERNED TO AVOID DAMAGING PRECEDENTS INVOLVING PAYMENT OF DISCOUNTED BOOK VALUE, OR UNREASONABLE DEDUCTIONS FROM COMPENSATION FOR BACK TAXES OR "EXCESS PROFITS," AND ATTEMPT WHENEVER POSSIBLE TO DISCOURAGE SETTLEMENTS OF THIS SORT. IN ADDITION, THERE MAY BE CIRCUMSTANCES IN WHICH THE USG DOES HAVE AN INTEREST DISTINCT FROM THAT OF THE INVESTOR--FOR EXAMPLE, WHERE AN INVESTMENT IS OF MAJOR SIGNIFICANCE TO THE U.S. ECONOMY.

6. WE APPRECIATE EMBASSY'S CONTINUING EFFORTS, AND WILL PROVIDE ADDITIONAL GUIDANCE AS APPROPRIATE IN VIEW OF EVOLVING EPMG COMPENSATION PROGRAM AND ITS PROPOSED APPLICATION TO U.S. INVESTMENTS. KISSINGER UNQUOTE INGERSOLL

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